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121A Corporations and Tax Letters of Agreement

An Analytical Evaluation

A Summary of Findings and Recommendations

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Background

In recent years, the City of Boston has been faced with increasing fiscal problems. Rapidly rising costs, often resulting from actions beyond the control of the City Administration, and a shrinking property tax base, from which the City must derive nearly 80% of its revenues, has forced the City of Boston to impose on its residents the highest property tax burden per capita of any major U.S. City.

Faced with this critical fiscal dilemma, the City Administration has made efforts to reduce costs (where possible) while seeking new sources of revenue; recognizing that the "only long-term solution" to Boston's fiscal problems lies with basic tax reform and a broadening of the City's revenue sources.

In the interim, the city is forced to seek whatever additional revenues possible from its existing taxable sources, without increasing the property tax burden beyond the financial endurance of the resident taxpayers. Therefore, any policy of the city, which appears to voluntarily reduce city revenues, is subject to increased scrutiny.

Consequently, considerable attention has been focused on 121A Corporations and their informal, extra-legal counterparts - Tax Letters of Agreement. These tax agreements, which currently number 148, involve a basic departure from the city's "normal" assessing and taxing practices in that, taxes are determined on the basis of "effective gross income" generated by the property instead of the full assessed value.

With 121A's and Tax Letters of Agreements (TL of A's), the developer has advanced knowledge of his tax liabilities and receives a tax reduction or subsidy, since the taxes paid under the agreed-upon percentage of Effective Gross Income (EGI) is generally well below the tax levy the property would pay if taxed on the basis of assessed value.

The basic difference (for tax purposes) between 121A Corporations and Tax Letters of Agreements is that 121A's are legally binding tax agreements, sanctioned by the State under Chapter 121A of the Massachusetts General Laws, and as such, the properties are "tax-exempt" and make "payments in lieu of taxes" to the city based on a specified formula which generally establishes the tax base at approximately 20% to 25% of EGI.[1]

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1. Under 121A, "payments in lieu of taxes" consist of (1) an excise tax, which is paid to the State and passed through to the city; and (2) "In-Lieu of tax payments" paid directly to the City Colletor's-Treasurer's Office

   The excise tax is determined on the basis of (1) 5% of total gross income generated by the property, plus (2) the larger of the following: (a) an amount equal to $10 per $1,000 of assessed fair cash value of the property (as of Jan 1 of that year)) <u>or</u>, (b) an amount equal to the Real Estate taxes that would be paid <u>by</u> the property based on the prior 3 year average of assessed value times the current tax rate.

   The In Lieu of Tax Payment's, which goes directly to the City, are the residual or shortfall between the amount the property pays in excise taxes and the total agreed upon (%) percentage of EGI as specified in the 121A Agreement, (e.g., a property which has agreed to pay 20% of EGI, may pay 12% of EGI in excise taxes, leaving 8% of EGI as the shortfall which is paid directly to the City as an "In lieu" of tax payment). The shortfall, however, is paid from profits in excess of the 6% (or 8%) return as specified in the 121A limited dividend Corporation agreement.

In contrast, Tax Letters of Agreement are extra-legal, non-binding tax agreements between the City and a real estate developer, whereby the City Administration states its intent to assess or tax the developer's project by some formula under which the project's real property tax liability is both more predictable and less in amount than if the project were assessed under the standard assessing schedule.

TL of A's, unlike 121A's, are not tax-exempt and have an assessed value which is included in the city's total assessed value of taxable property. However, the maximum level of taxes to be paid in the property are negotiated prior to construction and, like 121A's, are based on a percentage of effective gross income (usually 23% for office space). If the property tax rate is increased, the assessed value of the TL of A property is reduced proportinately so as to keep the total tax levy from going above the agreed upon % of EGI.[2]

In the past, 121A's and TL of A's have been justified as being "necessary" tax incentives to attract new development for Boston. But in light of the City's current fiscal plight, pertinent questions are being raised as to "how necessary" are these tax incentives and if the City can be justified in continuing to grant such tax agreements when they appear, on the face, to have such an adverse impact on the City's already inadequate and shrinking tax base.

2. This applies primarily to TL of A's negotiated prior to 1966, for TL of A's negotiated after 1966, the City is not obligated to reduce the assessed value on the property if the tax rate is increased.

The main purpose of this report is to examine in an analytical framework, precisely these questions and to provide recommendations on the course of action the City should take in dealing with 121A's and tax letters of agreement in the future.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

A. Summary of Findings:

I. Since 1958, 67 121A Corporations and 84 Tax Letters of Agreement, representing over $2 Billion in new development have been approved in the City of Boston.

The majority of 121A Corporations are residential developments, primarily subsidized housing, and are located outside the Downtown Area. In contrast, the majority of the Tax Letters of Agreement are commercial developments, with nearly 2/3rds of these developments located in the Downtown.

The 121A residential developments represent over 13,485 new units of housing and account for almost 2/3 of all the subsidized housing built in the city since 1961.

The commercial developments, built under tax letters of agreement, account for 12.5 million SF, out of the 16 million SF of new private office space built in the downtown since 1960, and they account for over 50% of all new retail and hotel development built in the city over the last 15 years.

TABLE I

Summary Table - 121A Corporations 1961-1976

Year	# of Total	121A Corporations by type Residen.	Comm.	Res./Comm.	Inst.	Total Annual Revenues From In-Lieu Payments (calendar Year)*
1961	2	1		1		-
1962	0					$ 460,479
1963	3	2		1		591,885
1964	0					694,097
1965	2	1		1		926,067
1966	2	1			1	1,140,949
1967	1		1			1,585,824
1968	7	7				2,034,047
1969	5	3	2			2,531,516
1970	2	2				3,404,859
1971	3	3				4,503,436
1972	4	4				5,941,058
1973	6	4		1	1	6,305,828
1974	8	6		2		7,184,330
1975	17	5	3	9		8,272,164
1976	2	2				9,200,000 (estimated)
Total 1961-1976	64	41	6	15	2	

*Includes "In-Lieu of Taxpayments" to the City and "Urban Redevelopment Excise Tax" which goes to the State and is then returned to the City via Cherry Sheets.

Note: The difference in totals is attributed to the 121A Corporations that either never proceeded or were taken over by other corps.

II. It appears, at the present time, that the City Administration does not collect sufficient information, nor performs adequate analysis or monitoring of the financial operations of existing 121A's or Tax Letters of Agreement to insure that the City receives the full Real Estate tax or "In Lieu of tax" revenues, (generally set at 20-25% of Effective Gross Income), as specified in the negotiated tax agreements.

While we were not given the opportunity to examine the individual 121A and Tax Letter of Agreements, there are several indications that the City was, (prior to the recent $56 tax rate increase), and to some extent still is, receiving tax payments or Payments In-Lieu of Tax (PILOT) (from a number of TL of A's and 121A Corps.) that are below the specified 20% to 25% of effective gross income.

As a result, in FY76, the City failed to collect an estimated <u>$5 million to $7 million</u> in potential tax revenues from the existing 148 121A;s and Tax Letters of Agreement becuase it did not effectively monitor the income generated by the tax agreement developments.

In FY77, however, this tax revenue shortfall was reduced significantly, when the City Administration decided not to reduce the assessed values on the Tax Letters of Agreement developments to offset the $56 tax rate increase. As a result, most of the commercial Tax Letters of Agreement are <u>now</u> paying the generally specified 23% (in some cases more) of Effective Gross Income. The 121A Corporation developments, however, were not adjusted and are, (along with several of the more recent Tax Letters of Agreement still paying less than 20-25% of EGI.

If <u>all</u> 121A Corps. and Tax Letters of Agreement developments were properly evaluated and the tax basis adjusted to reflect at least 20-25% of EGI, the City, in FY78 could obtain an additional <u>$2.5 million to $4 million</u> in tax revenues from the existing tax agreement developments.

III. The granting of special tax agreements have and will continue to be, (at least until there is some relief from the property tax and reform of the tax assessing practices), an essential requirement for attracting new development in the City of Boston.

Because of the City's heavy reliance on the property tax, (resulting in the highest property tax burden of any major city in the country), and the arbitrariness of the City's assessing practices, developers and the institutions which finance development, have and will continue to insist on special tax agreement prior to undertaking new development in the City.

While the insistence on tax agreements by developers is partially the result of the precedence established by existing 121A's Tax Letters of Agreement in most cases, the request for a tax agreement can be clearly justified on the basis of financial feasibility. With the present tax rate, assessing practices and the cost of development, it would not be economically feasible for a developer to undertake new development in the City of Boston without "certainty" of his future tax liabilities and some "level of tax subsidy" (i.e. the difference between what the development would pay under the standard tax assessing schedule compared to what it would pay using the special tax agreement formula which uses effective gross income as the tax basis).

It appears, however, that the need for "certainty" of future tax liabilities is far more critical to the developer than the actual level of tax subsidy.

The current tax agreement formula provides the developer in most cases with a reasonable rate of return on his investment. A typical new high rise office building taxed at 23% of EGI would generate approximately a 12% return for the developers after Real Estate taxes, but before state and federal taxes. In a highly leveraged project, through refinancing, accelerated depreciation, syndication, etc., the developer could achieve a rate of return of 18% to 20% after tax consideration.

While each development project should be analized separately, it does appear, that the "tax subsidy" is most critical to the developer in the first 5 years of the project, because of heavy front-end costs, rent-up uncertainties, etc. Therefore, it would seem possible for the City Administraton to gradually increase the tax basis on new commercial developments with tax agreements, particularly after the first 3-5 years, without seriously jeopardizing the financial viability of the project.

However, serious consideration must be given to maintaining the competitiveness of Boston's downtown office market vis-a-vis other major cities and the suburbs. Even with special tax agreements, with the tax base set at 23% of EGI, Boston has one of the highest property tax burdens on commercial office space of any major U.S. City. Boston ranks 2nd, only behind New York City, in the amount (and proportion of total rental income) that is paid in Real Estate taxes per S.F. of office space.

In comparision to Boston's overall average of approximately $2.10/S.F. (or 26.5% of rental income) for Real Estate taxes, the overall U.S. average for downtown office markets is $1.20/S.F. (or 15.6% of rental income) for Real Estate taxes. Even in the Middle Atlantic Region, which is the most costly region in the country, Real Estate taxes average $1.70/S.F. in downtown areas or approximately 20% of rental income.

It should be noted, however, that some cities have broader taxing powers than Boston, and impose other taxes on commercial developments in addition to the Real Estate taxes. San Francisco, for example, has a payroll tax; Minneapolis has a high personal property tax; and Detroit has a tax on value added. In these cities, the total amount of taxes paid by the commercial development to the local government may be equal, if not greater, than what is paid in Boston for Real Estate taxes.

TABLE II

Financial Analysis of New Office Development
Under 3 Alternative Tax Assumptions

Item:	121A/TL of A 23% of Gross	Full Value 31% of Value x $252.90/1000	Proportional Return (10% ROI)
1. Gross Revenue @ $14/s.f.	$ 10,085,000	$ 10,085,000	$ 10,085,000
2. Expenses:			
Operating @$2.50/s.f.	2,225,000	2,225,000	2,225,000
R. E. Taxes	2,319,500 (23%)	4,233,500 (42%)	2,522,400 (25%)
Debt Service * (9!%, 35 years)	4,527,600	4,527,600	4,527,600
TOTAL EXPENSES	9,097,100	10,986,100	9,275,000
3. Annual Cash Flow (3-5 yrs. out)	987,900	(901,100)	810,000
4. Return on Equity (%)	12.2%	(11.1%)	10.0%

1. Assumes A 900,000 s.f. office building with 87% efficiency factor and 90% occupancy in 1980.

* Development Cost @ $60/s.f. - $54,000,000

85% mortgage	45,900,000
15% Equity	8,100,000

IV. 121A Corporations and Tax Letters of Agreement developments, by the very nature of their function are relatively insulated from increases in the City's tax burden. As a result, there has been a gradual, but increasing shift in the proportionate tax burden from the downtown commercial area (where the majority of Tax Letters of Agreement are located) to the City's residential neighborhoods.

A brief review of summary tables III and III-A clearly indicates the relative decline of the downtown commercial area (Ward 3) as a tax revenue generator for the City.

Since 1950, while the City's overall assessed value of taxable property has increased by an average of 2/10 this of 1% per annum, the assessed value of taxable property has declined in the downtown commercial area (Ward 3) by an average of 7/10th's of 1% per annum. Consequently, since 1950, the growth in actual tax revenues in Ward 3 (CBD) have not kept pace with the overall growth in tax revenues for the city as a whole. While the downtown commercial area registered an average annual growth rate in tax revenues (including payments in-lieu of taxes) of 4.8% per annum over the past 26 years, the City, as a whole, had a growth rate of 5.8% per annum, and in strong residential neighborhoods, such as West Roxbury, the Real Estate tax revenues increased by 7.4% per annum over the 26 year period.

As a result, the proportion of the city's total tax revenues generated in the downtown commercial area (Ward 3) has declined from 31.5% in 1950 to 25.5% in 1976.

In more recent years, however, with the massive new commercial building boom in the downtown area (mid 1960's through 1975), the relative position of Ward 3 as a tax revenue generator for the city has improved. Since 1970, the downtown commercial area (Ward 3) has registered gains in assessed value and tax revenues above the city-wide averages for the first time since 1950. In the six year period, (1970-1976), the downtown commercial area has had an average annual growth in assessed value of 1.6% per annum, compared with 6/10th's of 1% for the city as a whole. Tax revenues generated in Ward 3 have increased by 13.5% per annum compared with the city-wide growth rate of 11.7%/yr. As a result, the proportion of the city tax revenues derived from Ward 3 have increased from a low of 23% in 1970, to the present 25.5% in 1976.

While the recent growth in tax revenues in Ward 3 is encouraging the growth is not commensurate with the increase in actual value (if appraised at full market value) of the new development which has occurred in Ward 3 since 1960.

The value of new office buildings, (builit under tax letters of agreement), in Ward 3 is approximately $600 million. If taxed under the standard assessing practices, these buildings would generate approximately $45 million in tax revenues for the city under the present tax rate. However, under the tax letters of agreement, those buildings currently generates $23.5 million in annual tax revenues. In other words, the new office development, built under Tax Letters of Agreement are getting a $21.5 million annual tax subsidy from the city. If we include the 64 121A Corporations, which in 1976 paid an estimated $9.2 million in PILOT to the city, (compared to approximately $42 million in Real Estate taxes these developments would have paid under the standard tax assessing schedule), the total city tax subsidy to 121A's and new downtown office buildings built under a TL of A amounts to over $53 million annually, at the current tax rate.

Looking at this from another perspective, with all the new construction in the downtown commercial area since 1960, the assessed value of taxable property in Ward 3 has increased by only $25 million. Applying the current tax rate and adding the estimated $2.2 million in PILOT from the 121A Corporations in Ward 3, the total net increase in tax revenues, directly attributable to the net growth in Ward 3's tax base, is $8.5 million, which accounts for only 13% of the total increase in tax revenues in Ward 3 since 1960.

While part of the relatively slow growth in tax revenues in the downtown commercial area (Ward 3) can be explained by the growth in tax exempt properties (excluding 121A Corporations), the basic fact is that the City has not been able to effectively capitalize, from a tax revenue perspective, on the substantial economic growth in the downtown area, because of the preferential tax treatment given new development. While "tax subsidies" are essential for attracting new development in Boston, it does seem the city could achieve greater tax revenue benefits from new economic development by avoiding "excessive tax subsidies" through more effective management and negotiation of tax-agreements.

TABLE III

Summary: Comparative Analysis of Changes In Assessed Value and Tax Revenues For City of Boston and Selected Wards: (1950-1976)

	Ward 3 (CBD)	Ward 20 (West Roxbury)	Ward 19 (Jamaica Plain)	City of Boston
Average Annual Change in Assessed Value				
1950-60	- 2.5%	1.5%	.4%	- .7
1960-70	- .3	2.8	1.0	.9
1970-74	+ 2.8	.8	.1	1.6
1974-76	- .7	.3	- 2.8	- 1.2
1950-76 (26 yr. Avg.)	- .7	1.8	.3	.2
1970-1976	+ 1.6	+ .6	- .1	+ .6
Average Annual Change in Total Revenues				
1950-60	2.2	6.3	5.2	4.1
1960-70	4.3	7.5	5.6	5.6
1970-74	9.3	6.7	6.6	7.9
1974-76	12.7	13.9	10.0	12.0
1950-76 (26 yr. Avg.)	4.8	7.4	5.9	5.8
1970-1976	13.5	11.3	8.8	11.7
Percent of Total City Revenues:				
1950	31.5%	3.7%	2.2%	-
1960	26.1%	4.6%	2.5%	-
1970	23.0%	5.5%	2.5%	-
1974	24.2%	5.2%	2.4%	-
1976	25.5%	5.4%	2.3%	-

Note: Information on assessed value and tax revenues are for calender years. Tax Revenues are based on assessed value (x) tax rate and do not reflect abatements, which would lower actual rax revenue income.

See Table I-A for details.

TABLE III-A

Analysis of Changes in Assessed Values & Tax Revenues
For City, Downtown & Selected Residential Wards (1950-1976)

	Assessed Value	Tax Rate (Per $1,000 Assessment Value)	Tax Revenue	121A Payments	Total Revenue
City of Boston:					
Calender Year: 1950	$1,429,900,000	$ 63.00	$ 90,083,700	-	$ 90,083,700
1960	1,336,732,600	100.70	134,608,970	-	134,608,970
1970	1,459,918,600	156.80	228,915,230	$ 2,220,850	231,136,080
1974	1,556,891,700	196.70	306,240,590	7,184,330	313,424,920
1976	1,518,212,000	252.90	383,955,810	9,000,000(est)	392,955,810
Ward 3-CBD					
1950	450,423,000	63.00	28,376,649	-	28,376,649
1960	348,623,700	100.70	35,106,406	-	35,106,406
1970	339,561,700	156.80	53,243,274	-	53,243,274
1974	378,675,300	196.70	74,485,431	1,401,649	75,887,080
1976	373,408,200	252.90	94,434,933	2,000,000(est)	96,434,933
Ward 19-Jamaica Plain					
1950	32,025,400	63.00	2,017,600	-	2,017,600
1960	33,226,000	100.70	3,345,858	-	3,345,858
1970	36,713,500	156.80	5,756,677	-	5,756,677
1974	36,906,600	196.70	7,259,528	184,000	7,443,528
1976	34,837,700	252.90	8,810,454	195,000	9,005,454
Ward 20-West Roxbury					
1950	$ 52,976,000	63.00	3,337,488	-	3,337,488
1960	61,249,000	100.70	6,167,774	-	6,167,774
1970	80,988,700	156.80	12,699,028	-	12,699,028
1974	83,636,000	196.70	16,641,201	5,000	16,451,201
1976	84,084,300	252.90	21,264,919	65,000(est)	21,329,919

Sources & Methodology:

Columns 1&2: Assessed Value and tax rates for 1950-1974 are for calender years; 1976 Assessed Value and Tax Rate based on 1977 fiscal years projections. Source - Assessing Dept. Annual Reports.

Column 3: Tax Revenue equals column 1 times column 2; Tax Revenue is not adjusted for abatements or delinquencies.

Column 4: Source - Auditing Dept. Annual Reports

Column 5: Total Revenue equals Column 3 plus Column 4.

V. In strictly cost/benefit terms, a typical new high rise office building in downtown Boston, built under a 121A or Tax Letter Agreement, generates more in tax revenues for the city than it costs the city to provide basic city services for the faciltiy.

Applying only the R. E. taxes or PILOT directly generated by a typical high rise office building in downtown Boston (assuming 23% of EGI), against the total direct and indirect city service cost, the revenue/cost ratio is 1.7. If we use only the direct city service costs, the revenue/cost ratio would be approximately 3.8.

In other words, under the most conservative estimate (i.e. highest service cost), the city receives $1.70 in tax revenues for every $1.00 it spends in providing services for a new high rise office building. Using the more traditional approach in cost-benefit analysis of this type - i.e. applying only the direct service cost - the city recieves approximately $3.80 for every $1.00 it spends on direct services for the office facility.

It was estimated that in 1976, it cost the City of Boston approx-imately $1.25/S.F. (or $1,250/1,000S.F.) to provide a typical new high rise office facility with all direct and indirect city services.*

Approximately 44% or .55¢/S.F. of the total service cost are attrib-utable to direct city services (e.g. police, fire, MBTA deficit, public works, etc.) The indirect city service cost (e.g. schools, health and hospitals, parks, and recreation, general administration, etc.) represents 56% off .70/S.F. of the total city cost for services.

With the total city service cost of $1.25/S.F., it is estimated that the "breakeven point" for the city is at a tax basis of approximately 14% of effective gross income for a typical new downtown office building (assuming 10% vacancy).

* It should be noted, that our estimate of total city service cost for a new high rise office building is significantly higher than what had been determined in comparable cost/benefit studies in other cities. In a comprehensive study done in San Francisco in 1974, city service costs for a new high office facility were estimated at $.34/S.F. to $.48/S.F.. In a recent study done in Cambridge, Mass, the city's cost for new office development was estimated at $.45/S.F.

TABLE IV

Summary: Changes In City of Boston Operating Budget: Direct and Indirect City Service Cost 1970 - FY 1975 and FY 1976

City of Boston Operating Budget

	1970	FY 1975	FY 1976
Direct Service Cost	$106,764,182	$148,811,331	$165,345,508
Indirect Service Cost	207,577,327	285,738,095	319,047,671
Total	$314,341,509	$434,549,426	$484,393,187

Change

	ABSOLUTE CHANGE			AVERAGE ANNUAL RATE OF CHANGE		
	1970-FY75	FY75-FY76	1970-FY76	1970-FY75	FY75-FY76	1970-FY76
Direct	42,047,149	16,534,177	58,581,326	6.9%	11.1%	7.6%
Indirect	78,160,768	33,309,584	111,470,352	6.6%	11.7%	7.4%
Total	120,207,917	49,843,761	170,051,678	6.7%	11.5%	7.5%

CITY OF BOSTON OPERATING BUDGET 1970 - FY1975 and FY1976

Direct and Indirect City Service Cost

Direct City Service Cost	1970 Expend.	1970 % City Total	FY 1975 Expend.	FY 1975 % City Total	FY 1976 Expend.	FY 1976 % City Total
Police	38,218,820	(12.2%)	57,886,333	(13.3%)	59,905,330	(12.4%)
Fire	24,819,437	(7.9%)	31,523,638	(7.3%)	38,628,072	(8.0%)
Traffic & Parking	2,152,389	(.7%)	3,247,034	(.7%)	3,803,326	(.8%)
Central Courts (County)	7,492,751	(2.4%)	11,184,092	(2.6%)	12,421,694	(2.5%)
District Courts (County)	3,131,562	(1.0%)	5,079,885	(1.2%)	5,645,309	(1.2%)
Public Works	15,427,612	(4.9%)	14,774,726	(3.4%)	13,395,502	(2.8%)
MBTA Deficit	15,521,611	(4.9%)	25,115,643	(5.8%)	31,546,295	(6.5%)
SUB-TOTAL (Direct Cost)	$106,764,182	(34.0%)	$148,811,331	(34.2%)	$165,345,508	(34.1%)
Indirect City Service Costs						
School Budget	93,444,218	(29.7%)	139,146,232	(32.0%)	171,099,048	(35.3%)
General Govt.	17,751,530	(5.6%)	31,345,018	(7.2%)	36,313,546	(7.5%)
Health & Hosp.	48,200,171	(15.3%)	59,593,272	(13.7%)	49,906,441	(10.3%)
Veterans Serv.	7,185,358	(2.3%)	4,218,328	(1.0%)	3,343,679	(.7%)
Library	6,075,182	(1.9%)	8,865,043	(2.0%)	9,194,342	(1.9%)
Parks & Rec.	7,068,786	(2.2%)	6,968,746	(1.6%)	7,827,090	(1.6%)
Misc.	15,431,187	(4.9%)	21,947,120	(5.1%)	26,465,111	(5.5%)
Other City	6,092,280	(1.9%)	4,615,490	(1.1%)	4,884,994	(1.0%)
Other County	6,330,645	(2.0%)	9,038,876	(2.1%)	10,018,458	(2.1%)
SUB-TOTAL (Indirect Costs)	$207,577,327	(66.0%)	$285,738,095	(65.8%)	$319,047,679	(65.1%)
TOTAL (Operating Budget)*	$314,341,509	(100.0%)	$434,549,426	(100.0%)	$484,339,187	(100.0%)

* Does not include Debt Servicing, Retirement/Pension and Assessment Costs which totaled an additional $106,325,000 in FY75 and $143,858,400 in FY76.

VI. Because of the preferential tax treatment given new office development under 121A and Tax Letters of Agreement the older office buildings, which are taxed under the standard assessed value basis, are at a competitive disadvantage in the downtown office market.

A typical, older Class C office building in the downtown will pay from 30% to 45% of its effective gross income in Real Estate taxes. (In some cases, where vacancies are at 50% or more, the effective tax levy is at 60% to 70% of EGI).

The gross tax inequities between old and new office buildings, (i.e. on a proportionate tax burden basis) must be ameliorated in the near future, if the city is to prevent further deterioration (and foreclosures) of older downtown commercial buildings. However, it is wrong to assume that the city loses tax revenues by the construction of new high rise office buildings and the movement of office tenants from the older to the newer office buildings.

Because of the higher density of development and the higher rent structures in high rise office buildings, the city collects more in tax revenue per S.F. of office space (assuming 23% of EGI) and per S.F. of land area from a new office facility than from an older commercial building.

The average high rise office tenant pays $2.12/S.F. in real estate taxes (23% of EGI) compared with $1.70/S.F.) for the typical Class C office tenant.

On a land area basis, the typical high rise office facilty (40 stories) will generate over $50/S.F. in tax revenues compared to an average of $12/S.F. in real estate taxes generated by an older office facility occupying approximately the same land parcel.

In a comparative analyses of recently constructed new high rise office facilities (under TL of A's or 121A), the new office buildings generated approximately $5.5 million more in tax revenues than would have been generated from these same land parcels under their original assessed values taxed at the current tax rate.

Another misconception is that new office buildings, "because of their special tax agreements" attract office tenants from the older commercial buildings in the downtown.

While new office buildings have drawn the majority of their tenants from the older downtown buildings, there are other factors, far more important than the relative real estate tax burden, which attract tenants into the new office space; e.g., the desire to upgrade the firm's image; the need for expansion space, technological changes requiring larger, modern and more efficient floor areas for office operations, the need to upgrade the office worker's environment, etc.

On a strictly cost basis, while the proportion lower tax burden (i.e. smaller % of total rental income going for real estate taxes) on newer buildings have enabled them to offer slightly more quality for the dollar to the tenant, the tenant moving from an older to a new office facility will pay significantly more in rent/S.F. and in real estate taxes/S.F. than he would in the older facility. The average rent for new Class A office space in Downtown Boston is currently $10.25/S.F. compared to an average of $5.27/S.F. for Class C office space.

TABLE V

CHANGES IN PROPERTY TAX REVENUES WITH NEW DEVELOPMENT

	Original Assessed Value	Est. Tax Revenues Bases On Original Assessed Value			121A/TL of A Tax Revenues 1977	Net Differential
		1966 ($101/1000)*	1973 ($196/1000)*	1977 ($252/1000)*		
Charlestown Savings Bank (121A)	$ 965,000	$ 97,465	$ 189,816	$ 244,049	$ 240,000 (1)	$ -4,049
One Beacon St. (121A)	80,000	8,080	15,736	20,232	1,400,000 (1)	1,379,778
State Street Bank (Letter of Agreement)	281,900	28,472	55,450	71,293	2,807,190 (2)	2,735,897
First Nat'l Bank (Letter of Agreement)	4,151,200	419,271	816,541	1,049,838	2,400,000 (2)	1,350,162
TOTALS	$5,478,100	$ 553,288	$1,077,543	$1,385,412	$6,847,190	$5,461,788

* Tax Rate

1. Tax revenues from 121A's (Charlestown Bank and One Beacon) were calculated, based on our estimation of Effective Gross Income with approximately 20% of EGI for in lieu of taxes payments.

2. Tax revenues from Letters of Agreement (State Street and First Nat'l Bank) were determined by using the 1977 Assessed Value for the buildings and applying the current tax rate ($252/$1,000).

   - 1977 Assessed Value for First Nat'l Bank $ 9,500,000
   - 1977 Assessed Value for State Street Bank $11,100,000

VII. While the tax inequities between old and new office space have developed because of different taxing methods, there has also developed a significant real estate tax differential or inequity between many of the newer (tax agreement) office facilities, which is more difficult to explain.

Real estate taxes on new office buildings in the downtown range from a low of <u>$1.50/S.F.</u> to as high as <u>$3.00/S.F.</u> and more.

A classic example of tax inequities between new office buildings is the First National Bank and State Street Bank buildings. Both are tax letter of agreement developments, yet the First National Bank Building (opened in 1971) which has a gross square footage of 1,175,000 S.F., a 95% to 97% occupancy rate, and rental range of $9.50 to $11.50/S.F., was assessed at $9.5 million in 1971 and paid $2.4 million in real estate taxes. In comparision, the State Street Bank Building, with 852,000 S.F. of office space, a rental range of $8.50 to $10.50 S.F. and occupancy of 90% to 92%, was assessed at $11.0 million and paid $2.8 million in real estate taxes in 1977.

There are several other cases with similar tax discrepencies.

In the absence of the actual tax letter of agreement on these buildings, we have assumed that the tax inequities are the result of poor monitoring of rental income (i.e. some buildings are not paying the full 23% of EGI, while other buildings are paying more), and the lack of standardized definitions on such items as the computation of effective gross income.

The tax differential between newer office buildings, unlike the tax inequities between the old and new office facilities, has a significant impact on the relative competitiveness of these office facilities, particularly in a weak office market.

TABLE VI

Recent Office Development in Downtown Boston
Built Under Tax Letters of Agreement and 121A Corporation

Address	Gross Leasable Office Space (in sq. ft.)	1977 Assessed Value Land	Bldg.	Total	Assessed Value of Building/Sq.Ft. of office space	Est. FY. 1977 Tax Payment ($252.90/$1,000)	Est. Tax Per S.F.
Tax Letter of Agreement (Ward 3)							
125 High St.	285,000	1,000,000	3,300,000	4,300,000	11.6	1,087,470	3.82
133 Federal St.	142,000	200,000	65,000	85,000	4.6	814,965	1.51
225 Franklin St.	852,000	1,500,000	9,600,000	11,100,000	11.3	2,807,190	3.29
70 Federal	60,000	400,000	401,600	801,600	6.7	2027,24.6	3.88
Center Plaza	600,000	1,404,500	4,299,200	5,703,700	7.2	1,442,465.7	2.40
20 Ashburton Pl.	35,000	109,300	284,600	393,900	8.1	99,617.9	2.85
28 State St.	590,000	993,000	5,507,000	6,000,000	9.3	1,643,850	2.79
100 Charles River Plaza	130,000	223,500	821,500	1,045,000	6.3	264,280.5	2.03
25 New Chardon	80,000	167,900	572,100	740,000	7.2	187,146	2.34
55 Court St.	50,000	865,000	335,000	600,000	6.7	157,740	3.03
One Boston Pl.	825,000	1,500,000	6,148,000	7,648,000	7.5	1,934,179.2	2.34
15 New Chardon	75,000	200,000	460,000	660,000	6.1	166,914	2.23
100 Federal St.	1,175,000	3,166,500	6,333,500	9,509,000	5.4	2,402,550	2.04
99 High St.	775,000	600,000	6,300,000	6,900,000	8.1	1,745,010	2.25
One Washington Mall	140,000	453,700	1,215,000	1,668,700	8.7	422,014.2	3.01
1 Bulfinch Pl.	45,000	189,600	395,000	584,600	8.8	147,845.3	3.29
141 Tremont St.	66,000	378,500	520,100	898,600	7.9	227,255.9	3.44
30 Winter St.	105,000	490,000	510,000	1,000,000	4.9	252,900	2.41
100 Summer St.	1,000,000	-	11,400,000	11,400,000	11.4	2,883,060	2.88
50 Staniford St.	200,000	480,000	1,519,200	2,000,000	7.6	505,800	2.53
1 Federal St.	1,108,000	1,695,000	4,835,000	6,530,000	4.4	1,651,437	1.49
Federal Reserve	1,138,500	2,500,000	4,500,000	7,000,000	3.9	1,770,300	1.55
60 State St.	700,000	1,600,000	2,730,000	4,330,000	3.9	1,095,057	1.56
175 Federal St.	200,000	282,000	475,900	757,900	2.4	191,672.9	.96

Table A-II continued

Address	Gross Leasable Office Space (in sq. ft.)	1977 Assessed Value Land	1977 Assessed Value Bldg.	1977 Assessed Value Total	Assessed Value of Building/Sq.Ft. of office space	Est. FY. 1977 Tax Payment ($252.90/$1,000)	Est. Tax Per S.F.
Sub-Total (Bldgs. in Ward 3)	10,376,500	19,799,300	73,112,700	92,912,000	7.0	23,497,444.8	2.26
Other: Tax Letter of Agreements							
500 Boylston	54,000	300,000	430,000	730,000	8.0	184,617	3.42
545 Boylston	85,000	117,600	782,400	900,000	9.2	227,610	2.68
Hancock Place	2,000,000	2,558,400	19,416,600	21,900,000	9.7	5,538,510	2.77
Total: Tax Letter of Agreements	12,515,500	22,775,300	93,666,700	116,442,000	5.8	29,448,181	2.35
121A Corps (Tax Exempt)							
800 Boylston St.	1,000,000						
101 Huntington-Pru Center	432,000						
One Beacon St.	1,020,000					1,500,000	1.87
55 Summer St. - Charlestown Bank	140,000						
245 Summer St.	950,000						
Sub-Total 121A	3,542,000						
Grand Total	16,057,500						

B. <u>Summary of Recommendations</u>:

I. The City should improve and centralize its data collection efforts in regard to the administration of 121A's and Tax Letters of Agreement. In addition, the City administration should establish more effective and on-going monitoring of the financial operations of development facilities which have special tax agreements.

It is suggested that the administration and monitoring of all 121A's and Tax Letters of Agreement be the responsibility of one central office, "properly staffed" and located in the Department of Collector-Treasurer.

This office would, among other functions, perform annual evaluations of the financial operations of all existing tax-agreement developments and would provide detailed financial and public cost/benefit analyses on all future applications for 121A's and Tax Letters of Agreement.

The actual auditing of the financial-operational statements for the tax agreement developments could be done by a private accounting firm contracted by by the City. This would allow for more effective and objective evaluations and would be more acceptable to the business community.

II. If the City administration is going to continue to foster substantial economic development in the City, it will have to continue to grant 121A's or Tax Letters of Agreement or similar special tax arrangements to prospective developers; at least until there is basic tax reform and a reduction in the property tax burden.

New commercial development, even with special tax agreements, provides the City with tax revenue benefits that are well above the cost for providing City services.

When the job generation and spinoff impacts from the new commercial developments are taken into consideration, along with the direct net tax revenue benefits, the City obtains significant economic benefits from new development.

However, while a tax agreement is essential to promote new development in the City, it is not necessary for the City to provide "excessive tax subsidies". Through more effective monitoring and negotiations, the City would achieve even greater tax revenue benefits from new, as well as existing, commercial developments, without jeopardizing the economic growth potential of the City.

III. All new 121A's and Tax Letters of Agreement, as well as the existing Tax Letters of Agreement should be renegotiated for five to seven year periods with an automatic renewal option. If possible, (pending State approval of the home rule petition to tax properties under different classifications), the present Tax Letters of Agreement should be replaced with a more permanent, legally-binding tax agreement which taxes all commercial development in the City strictly on an income basis. This would insure the developer greater certainty, provide for easier and more efficient administration of tax agreement development projects, and drastically reduce the gross tax inequities which now exists between old and new commercial facilities.

IV. The tax basis (% of Effective Gross Income) for 121A's and Tax Letters of Agreement should be on a "sliding scale", ranging from a low of 20 percent to an upper level maximum of about 30 percent. The initial tax basis for the development should be negotiated on a proportional return basis, and thereafter, provide the development is financially viable, the tax basis would be gradually increased up towards the maximum level of 30 percent of Effective Gross Income.

Furthermore, it is recommended that any new 121A's or Tax Letters of Agreement that are negotiated by the City should take into account recommendation #1 and have as part of the agreement the requirement that the owner must file complete and accurate (certified and verified by State Corporation Tax Records) financial statements on the operations of the facility with the City's Collector-Treasurer (and/or a private accounting firm) on an annual basis.

In addition, (following recommendation 1), the developer applying for a 121A or Tax Letter of Agreement should be required to provide the Collector-Treasurer's office a complete financial analysis on the project (preferably the one submitted to the lending institution) in sufficient time for the City to prepare for negotiations with the developer on his tax agreement application.

V. The City should make provisions in all future tax agreements (as well as renegotiated Tax Letters of Agreement) to allow for some pass-through of increases in the City's tax rate, so as to prevent the further shifting of tax burden increases from the downtown commercial area to the City's residential neighborhoods.

This could be accomplished through the use of the "sliding scale" approach outlined in the previous recommendation. Instead of having an arbitrary, predetermined increase in the tax basis (% of EGI), the City could tie the increase in the tax basis to increases in the tax rate; whereby, the increase in the tax burden (as a result of the tax rate hike) for the average homeowner in the City is proportionate to the increase, on a per square foot basis, in the real estate taxes paid by a tenant in a downtown office facility.

Based on the current average assessed value of single-family residential properties and the average annual effective gross income from a new office facility, it is estimated that for every $10 increase in the tax rate, the tax basis (or % of Effective Gross Income) on a new office facility should increase by approximately one percentage point, so as to reflect the comparable increase in the tax burden for a typical single family homeowner in the City.

VI. The City should undertake, expeditiously, a program to reduce the tax inequities between older and newer commercial facilities, which, at the same time, will foster the conversion or upgrading of the older Class C and D office facilities.

This can be accomplished through provision of special tax incentives, (similar to that provided to new development) via a tax abatement program, which allows the developer to receive a predetermined, gradually declining tax abatement on the property he will rehab or convert to a higher and better use.

In this way, the developer is given a needed tax subsidy while he is undertaking renovations, but as the property is rented-up, the abatement is reduced, and eventually, (by the third year), the property is taxed on an income basis, similar to new commercial facilities.

APPENDIX

LIST OF 121A CORPORATIONS

(1961 - 1976)

TABLE A-1

1961 to Current

BOSTON REDEVELOPMENT AUTHORITY

121A Corporations

YEAR	SPONSOR	LOCATION	TYPE OF DEVELOP.	ESTIMATED COST	# OF D.U.'s	FINANCING	APPROVAL BRA	DATES: MAYOR
1961								
1.	Charlesbank Apts.	Whitney St. Proj.	Residential	$ 4,500,000	277	FHA 220	02/01/61	02/10/61
2.	Prudential Ins. Co.	Pru Ctr./Back Bay	Res. & Com.	190,000,000	812	Eq./Invest.	08/14/61	08/14/61
1963								
3.	Back Bay Towers Inc.	Whitney St. Proj.	Residential	3,500,000	143	FHA 220	06/27/62	07/18/63
4.	Jamaicaway Dev. Co.	Jamaica Plain	Residential	6,700,000	282	FHA 220	02/27/63	03/08/63
5.	Stadium Apts. Inc.	(dissolved)					04/03/63	04/11/63
6.	Buse Boston Inc. (Academy Homes)	Wash. Pk.	Res. & Com.	3,332,883	202	FHA 221(d)(3)	05/01/63	05/09/63
1965								
7.	Waverly Apts. Inc.	Allston	Residential	2,475,900	103	FHA 221(d)(3)	11/19/64	08/03/65
8.	Warren Gardens Inc.	Wash. Pk.	Res. & Com.	4,369,100	227	FHA 221(d)(3)	09/30/65	10/15/65
1966								
9.	Back Bay Manor Apts. Inc.	Whitney St. Proj.	Residential	6,193,600	288	FHA 220	04/28/66	04/28/66
10.	Trustees of Church Realty Trust	Fenway	Admin. Bldg. & School	8,000,000	None	Eq./Invest.	06/02/66	08/16/66
1967								
11.	New Boston Food Mkt. Development Corp.	South Bay Area	Commercial	9,000,000	None	SBA/Priv.Fin.	08/02/67	09/05/67
1968								
12.	St. Joseph Homes Inc.	Wash. Pk.	Residential	2,625,000	138	FHA 221(d)(3)	04/11/68	05/01/68
13.	Cam-Field Inc.	South End	Residential	2,520,000	135	FHA 221(d)(3)	09/19/68	09/30/68
14.	Westminster Pl. Inc.	South End	Residential	2,087,000	110	FHA 221(d)(3)	10/03/68	10/16/68
15.	Willard Place Inc.	South End	Residential	3,100,000	153	FHA 221(d)(3)	10/03/68	10/16/68
16.	Jewish Comm. Hsg. for the Elderly	Brighton	Residential	5,600,000	340	CFA Sec. 202	10/31/68	11/21/68
17.	Roxse Homes Inc.	South End	Residential	8,830,400	364	FHA 221(d)(3)	11/07/68	11/21/68
18.	Columbus Ave. Hsg. Corp.	South End	Residential	3,084,000	140	FHA 221(d)(3)	11/07/68	11/21/68

Table A-1 continued

YEAR	SPONSOR	LOCATION	TYPE OF DEVELOP.	ESTIMATED COST	# OF D.U.'s	FINANCING	APPROVAL BRA	DATES: MAYOR
1969								
19.	CharlesNEWtown Inc.	Charlestown	Residential	$ 5,756,100	262	FHA 221(d)(3)	01/23/69	02/21/69
20.	Charlesview Inc.	N. Harvard	Residential	4,400,000	200	FHA 221(d)(3)	03/20/69	04/08/69
21.	Tremont Homes Inc.	South End	Residential	1,640,000	82	FHA 221(d)(3)	05/07/69	05/22/69
22.	Port Dev. Co. Inc.	East Boston	Commercial	8,000,000	None	Conventional	07/28/69	01/70
23.	Northern Assurance Co. of America a/k/a Employers Commercial	Beacon/Tremont St.	Commercial	55,000,000	None	Eq./Invest.	08/28/69	09/12/69
1970								
24.	St. Joseph's Comm. Inc. (take over, St. Joseph's Homes - #12)						05/07/70	06/02/70
25.	Tai Tung Apts. Co.	South Cove	Residential	7,276,678	214	FHA 221(d)(3)	09/03/70	09/29/70
26.	Rutland Hsg. Assoc.	South End	Residential	1,150,000	44	FHA 221(d)(3)	10/08/70	10/20/70
27.	Franklin Sq. Apts (take over, Back Bay Towers - #3)						11/19/70	12/04/70
1971								
28.	E.T.C. Corporation	South End	Residential	1,407,000	71	FHA 236	01/21/71	02/01/71
29.	Mass. Pike Towers	South Cove	Residential	6,400,000	200	FHA 236	02/25/71	03/01/71
30.	Morville House	Fenway	Residential	3,067,905	147	FHA 236	09/30/71	10/12/71
1972								
31.	Ebenezer Homes Inc.	South End	Res./Rehab	545,620	32	MHFA	12/16/71	01/06/72
32.	Lower Roxbury Dev. Corp.	Campus High	Residential	8,175,617	283	MHFA	02/10/72	02/18/72
33.	Jewish Comm. Hsg. for Elderly II Inc.	Brighton	Residential	5,350,000	256	CFA Sec. 202	03/30/72	04/12/72
34.	Newcastle Associates	South End	Residential	1,748,400	105	MHFA	07/20/72	08/04/72
1973								
35.	Summer St. Realty Corp.	South Station	Commercial	35,000,000	None	Eq./Invest.	02/22/73	03/01/73
36.	Rockingham Glen	West Roxbury	Residential	3,400,000	141	MHFA	04/05/73	04/12/73
37.	Chauncy House Co.	Downtown Boston	Res. & Com.	1,220,000	87	FHA 236	04/19/73	05/01/73
38.	Tenants' Dev. Corp. & Wingate Dev. Corp.	South End	Residential	4,124,000	185	FHA 236	06/28/73	07/12/73
39.	101 Commonwealth Assoc.	Boston	Residential	3,139,000	97	MHFA	11/08/73	11/21/73
40.	Concord House Assoc.	South End	Residential	4,847,000	181	FHA 236	11/08/73	11/21/73

Table A-1 continued

YEAR	SPONSOR	LOCATION	TYPE OF DEVELOP.	ESTIMATED COST	# OF D.U.'s	FINANCING	APPROVAL BRA	DATES: MAYOR
1974								
41.	Viviendas Associates	South End	Residential	5,329,444	181	FHA 236	08/15/74	08/26/74
42.	E. Boston Comm. Assoc.	East Boston	Residential	2,355,839	96	MHFA/Priv. 10%	10/31/74	11/22/74
43.	Mercantile Wharf Assoc.	Waterfront	Res. & Com.	4,763,000	121	MHFA/Priv. 10%	11/14/74	11/26/74
44.	Quincy Tower Assoc.	South Cove	Residential	5,165,000	162	MHFA/Priv. 10%	11/21/74	11/27/74
45.	Franklin Pk. Assoc.	Rox/Dorchester	Residential	5,989,928	228	MHFA/Equity	11/21/74	11/27/74
46.	Waters & Company	South End	Residential	234,120	8	MHFA	12/05/74	12/26/74
47.	Gardner Apts. Assoc.	Campus High	Res. & Com.	1,353,812	49	MHFA	12/05/74	12/26/74
48.	St. James Co.	South End	Residential	3,300,000	182	MHFA	12/19/74	12/26/74
1975								
49.	Jamaica Plain Assoc.	Jamaica Plain	Res. & Com.	4,540,000	147	MHFA	03/06/75	03/12/75
50.	Charlestown Savings Bank	Downtown Boston	Commercial	9,000,000		Private	04/03/75	05/08/75
51.	Al Jordan Realty Corp.	Downtown Boston	Commercial	30,000,000		Conventional	05/01/75	05/16/75
52.	Conway Court Assoc.	Roslindale	Residential	728,000	28	MHFA	05/01/75	06/10/75
53.	Jewish Comm. Hsg. for for Elderly III Inc.	Brighton	Residential	5,750,000	212	MHFA	06/12/75	07/17/75
54.	Anderson St. Assoc.	West End	Res. & Com.	1,800,000	59	MHFA	07/10/75	08/05/75
55.	Mission Pk. Corp.	Mission Hill	Res. & Com.	44,416,209	774	MHFA	07/10/75	09/25/75
56.	Woodbury Cunard Assoc.	East Boston	Res. & Com.	1,198,253	41	MHFA	07/30/75	10/20/75
57.	Medical Area Total Energy Plant Inc.	Fenway	Commercial	56,410,000		Conventional	10/09/75	12/08/75
58.	Blackstone Co.	West End	Res. & Com.	5,760,000	176	MHFA	09/25/75	09/30/75
59.	Symphony Plaza East	Fenway	Res. & Com.	5,920,000	188	MHFA	09/25/75	09/30/75
60.	Symphony Plaza West	Fenway	Res. & Com.	6,730,000	216	MHFA	09/25/75	09/30/75
61.	Headstart Hsg. Assoc.	South End	Residential	4,835,416	156	Sec. 8 C.D.	07/10/75	10/20/75
62.	Victory Gardens Assoc.	East Boston	Residential	2,401,572	87	MHFA/Priv. 10%	10/09/75	10/31/75
63.	Reservoir Towers Assoc.	Brighton	Res. & Com.	9,669,244	242	MHFA/Priv. 10%	10/09/75	10/20/75
64.	Bowdoin School Assoc.	Downtown Boston	Residential	993,958	35	MHFA/Priv. 10%	11/20/75	12/08/75
65.	Borinquen Assoc.	South End	Res. & Com.	1,150,000	36	MHFA	12/04/75	12/23/75
1976								
66.	Back Bay Restorations Inc.	Back Bay	Residential	2,225,000	86	Private	05/06/76	05/24/76
67.	Ausonia Homes Assoc.	Waterfront	Residential	5,800,000	151	Sec. 236	09/09/76	09/13/76

Summary:

67 121A CORP Approved — Representing $655 million in Development

64 121A Currently in existence — " 9962 units of Housing